



# STATE BOARD OF EQUALIZATION

## STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced:	<b>02/21/03</b>	Bill No:	<b>SB 764</b>
Tax:	<b>Property</b>	Author:	<b>Morrow</b>
Board Position:		Related Bills:	<b>AB 322 (Parra)</b>

### BILL SUMMARY

This bill would increase the disabled veterans' exemption to \$200,000 for the basic exemption and \$250,000 for the low income exemption and thereafter annually increase the amount of the exemption by an inflation factor.

### ANALYSIS

#### Current Law

Article XIII, Section 4 of the California Constitution provides that the Legislature may exempt from property tax, in whole or in part, the home of a person or a person's spouse, including an unmarried surviving spouse, if the person, because of injury incurred in military service, is totally disabled. This exemption is commonly referred to as the "disabled veterans' exemption." The disabled veterans' exemption is also available to the surviving spouse of a person who has died as a result of a service connected injury or death while on active duty in military service.

Revenue and Taxation Code Section 205.5 provides the statutory implementation of the disabled veterans' exemption. A \$100,000 "basic exemption" is provided on a one time filing basis to qualified persons. If household income is less than a specified amount, the amount of the exemption is \$150,000. The income threshold for the "low income exemption" is adjusted annually by an inflation factor. For the 2003 assessment year, the household income limit was \$42,814. The "low income exemption" requires an annual filing to reaffirm income eligibility.

Qualification	Basic Exemption	Low Income Exemption (\$42,814)
<b>Veteran</b> Disability Rating = 100% Disability Compensation = 100% Blind Lost Two or More Limbs	<b>\$100,000</b>	<b>\$150,000</b>
<b>Spouse of Military Personnel</b> Surviving Spouse of Disabled Veteran Surviving Spouse of Person Killed in Active Duty		

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### **Proposed Law**

This measure would amend Section 205.5 of the Revenue and Taxation Code to increase the amount of the exemption to **\$200,000** for the basic exemption and **\$250,000** for the low income exemption. In addition, this measure would, commencing on January 1, 2004, and for each assessment year thereafter, annually compound these exemption amounts by an inflation factor. The factor would be based on the annual percentage change, measured from February to February of the two previous assessment years in the California Consumer Price Index for all items.

This bill is keyed as a tax levy and would be effective upon chaptering.

### **In General**

There are two property tax exemptions available for persons who have served in the military: (1) the veterans' exemption and (2) the disabled veterans' exemption.

#### **Veterans' Exemption**

The veterans' exemption applies to any property subject to property tax (for instance, real property; property used in a trade, profession or business; boats; or planes) owned by an eligible veteran. The exemption is also available to the unmarried surviving spouse of the veteran and the parents of a deceased veteran. The exemption is in the amount of \$4,000 of full cash value, providing up to \$40 of tax savings. However, the exemption is nearly extinct. At its peak, from 1956 through 1962, over one million persons received the veterans' exemption. Today, fewer than 40 veterans receive the exemption.

The decline of the veterans' exemption is due to two factors. First, the homeowners' exemption was increased in 1974 to an amount greater than the veterans' exemption.<sup>1</sup> The homeowners' exemption, in the amount of \$7,000 of full cash value, provides tax savings of up to \$70. Consequently, veterans who own homes instead switched to the homeowners' exemption available to any Californian. Secondly, the remaining non-home owning veterans are unable to qualify for the veterans' exemption due to strict wealth limitations fixed in the Constitution. Those limitations are a personal wealth cap of \$5,000 for an unmarried veteran and \$10,000 for a married veteran, as specified. (See Revenue and Taxation Code §205 and Section 3 of Article XIII of the Constitution.)

#### **Disabled Veterans' Exemption**

Section 4(a) of Article XIII of the California Constitution grants the Legislature the authority to exempt from property tax, in whole or in part, the home of a person (or a person's spouse) who is injured in military service. This exemption is commonly referred to as the "disabled veterans' exemption." Injuries that qualify a veteran for the exemption include: (1) a disability rating at 100%, (2) blindness, and (3) lost use of two or more limbs. Additionally a veteran that has a disability compensation rating at 100%

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<sup>1</sup> The homeowners' exemption was first adopted via constitutional amendment (Proposition 1A; 1968 Cal. Res. 9, extra session in 1968, SCA 1). The exemption increased from \$3,000 to its current level of \$7,000 via a second constitutional amendment in 1974 (Proposition 6, 1974 Cal. Res. 77 SCA 26).

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because he or she is unable to secure or follow a substantially gainful occupation is also eligible for the disabled veterans' exemption. The spouse of a disabled veteran is able to maintain the exemption after the veteran's death as long as the spouse is unmarried. Additionally, since 1994, pursuant to a constitutional amendment, (Proposition 160, November 1992) the unmarried spouse of a person who dies as a result of a service-connected injury or disease while on active duty is able to qualify for the disabled veterans' exemption.

Section 205.5 of the Revenue and Taxation Code implements the Legislature's authority to provide a property tax exemption for disabled veterans and/or their unmarried surviving spouses.

### Background

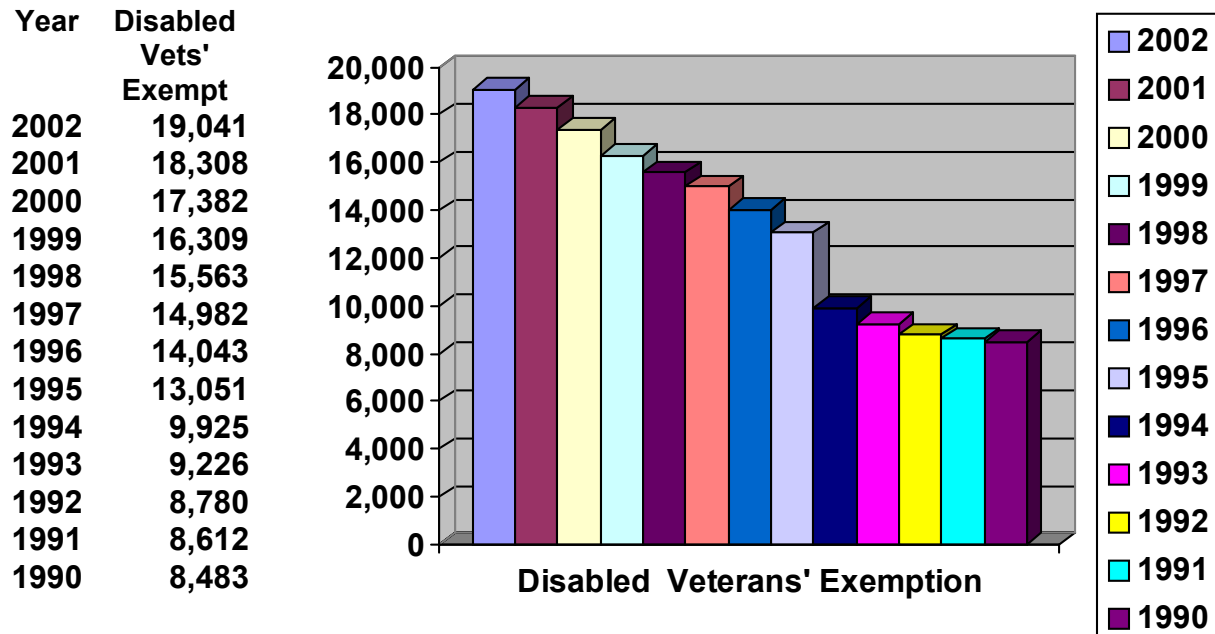
For the 2002-03 fiscal year, a total of 19,041 disabled veterans' exemption claims were granted. The total amount of assessed value exempt was \$1,566,373,000. The following table lists the number of disabled veterans' exemptions claimed in each of the 58 counties in order of those counties with the greatest number of claims.

#### 2002 Exemption Claims Per County

San Diego	3349	Merced	242	Calaveras	59
Los Angeles	1386	Placer	231	Del Norte	55
Sacramento	1317	San Mateo	204	Yolo	54
Riverside	1188	Tulare	199	Siskiyou	48
Solano	1000	San Luis Obispo	178	Mariposa	42
San Bernardino	975	El Dorado	176	Imperial	41
Orange	967	Marin	174	Amador	38
Monterey	766	Humboldt	153	Plumas	33
Contra Costa	590	Nevada	141	Lassen	24
Santa Clara	493	Lake	138	Trinity	21
Alameda	471	San Francisco	132	San Benito	20
Shasta	455	Sutter	126	Glenn	16
Ventura	435	Mendocino	126	Modoc	12
Fresno	424	Santa Cruz	118	Colusa	11
Sonoma	352	Yuba	112	Inyo	5
San Joaquin	328	Tehama	100	Sierra	5
Stanislaus	300	Napa	99	Mono	2
Kern	283	Kings	95	Alpine	1
Butte	281	Madera	84		
Santa Barbara	267	Tuolumne	68		

#### 1990-2002 Statewide Exemption Claims

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## COMMENTS

1. **Sponsor and Purpose.** This bill is sponsored by the Cal-Diego Paralyzed Veterans Association in an effort to increase the amount of the exemption.
2. **The Exemption Amount Has Not Been Increased Since 1989.** The current exemption amounts have been in effect since 1989. In 2000, the income threshold for the low income exemption of \$150,000 was increased from \$24,000 to \$40,000 and instituted an automatic annual inflation factor.
3. **Operative Date Should Be Delayed to January 1, 2004.** As a tax levy, the provisions of this bill would be effective immediately. However, if this bill becomes law, property tax bills reflecting the current exemption amounts would have already been prepared. It would be preferable to make the provisions of this bill operative on January 1, 2004 and delay to January 1, 2005 the first year of the inflation factor to the new exemption amounts of \$200,000 and \$250,000.
4. **State Does Not Subvene Property Tax Revenue Loss from the Disabled Veterans' Exemption.** The homeowners' exemption is the only property tax exemption for which the state fully reimburses local government. The state also makes subvention payments to offset property tax reductions for open space and agricultural property that receives preferential assessment treatment under the Williamson Act at the rate of \$1 per acre for non-prime land and \$5 per acre for prime land.
5. **This Bill Would Automatically Increase the Exemption Amount Each Year.** For the 2004 year and each year thereafter, the exemption would be compounded

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annually by an inflation factor. The inflation factor specified is the same measurement period that is used for purposes of increasing the income threshold level.

6. **Double-Joining Language - Related Bill.** AB 322 (Parra) would also amend Section 205.5 of the Revenue and Taxation Code to ensure that a disabled veteran that is confined to a care facility or hospital would continue to be eligible to receive the exemption. Double joining language is needed if both bills become enacted into law.

## **COST ESTIMATE**

With respect to property taxes, the Board would incur some minor absorbable costs in informing and advising local county assessors, the public, and staff of the law changes as well as the annual amount of the exemption.

## **REVENUE ESTIMATE**

### **Background, Methodology, and Assumptions**

Existing property tax law provides for an exemption in the amount of \$100,000 for the principal residence of a disabled veteran, but increases that amount to \$150,000, if the claimant's income does not exceed \$40,000 as adjusted by inflation.

Regarding the increase of the basic exemption, for properties with assessed value (AV) less than \$100,000, there will be no revenue impact. For properties with AV between \$100,000 and \$200,000, the entire AV will be exempt, leaving no taxable amount. Properties with AV over \$200,000 will continue to claim the basic disabled veterans' exemption, but an additional \$100,000 would be exempt, leaving only the AV over \$200,000 as the taxable portion.

Regarding the increase of the low income exemption, properties with AV less than \$150,000 will no longer be required to qualify for the low income exemption, as their entire AV will be absorbed into the basic disabled veterans' exemption up to \$200,000. Properties with AV between \$150,000 and \$200,000 will also no longer be required to qualify for the low income exemption, as their entire AV will also be absorbed into the basic disabled veterans' exemption up to \$200,000. Properties with AV between \$200,000 and \$250,000 will remain in the low income category, but the entire AV will be exempt, leaving no taxable portion. Properties with AV over \$250,000 will remain in the low income category, and an additional \$100,000 would be exempt, leaving only the AV over \$250,000 as the taxable portion.

The revenue impact of this bill is twofold: the initial impact, and the future impact measured by the inflation factor.

Based on an analysis of the current veterans' exemptions in a number of counties, we estimate the distribution as follows:

### **Basic Exemption**

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<u>2002-03 Assessed value</u>	<u>Number</u>	<u>Increase in exempt AV</u>
Under \$100K	10,065	\$0
Between \$100K and \$200K	4,915	\$195.4 million
Over \$200K	<u>2,071</u>	<u>\$207.1 million</u>
Total	17,051	\$402.5 million

### Low Income Exemption

<u>2002-03 Assessed value</u>	<u>Number</u>	<u>Increase in exempt AV</u>
Under \$150K	1,080	\$0
Between \$150K and \$200K	543	\$11.0 million
Between \$200K and \$250K	218	\$15.9 million
Over \$250 K	<u>150</u>	<u>\$15.0 million</u>
Total	1,991	\$41.9 million

It is likely that claimants in the group under \$150K would be converted to basic exemptions, and therefore no longer be required to apply for the low income exemption. In addition, it is likely that the claimants in the group between \$150K and \$200K would also convert to the basic category. As a result, the number of low income claimants would drop by over 80 percent, from 1991 to 368.

### Inflation Factor Adjustment

Under this bill, the amount of the disabled veterans' exemptions would be adjusted annually to reflect cost of living increases. This adjustment would be based on the year-to-year increase in the California Consumer Price Index (CCPI) for all items, as of February of each year. The year-to-year changes in the CCPI for the preceding seven years have generally been modest increases, ranging from 1.302 percent in 1996 to 4.535 percent in 2001, dropping sharply to 2.32 percent in 2002. Assuming that the inflation adjustment lies in the 1 to 5 percent range, and that the adjustment applies beginning with the January 1, 2004 lien date, the exemption amounts in the first five years can be estimated to grow as follows:

For the basic exemption amount of \$200,000:

2004-05	$\$200,000 \times (1.01 \text{ to } 1.05) = \$202,000 \text{ to } \$210,000$
2005-06	$(\$202,000 \text{ to } \$210,000) \times (1.01 \text{ to } 1.05) = \$204,020 \text{ to } \$220,500$
2006-07	$(\$204,020 \text{ to } \$220,500) \times (1.01 \text{ to } 1.05) = \$206,060 \text{ to } \$231,525$
2007-08	$(\$206,060 \text{ to } \$231,525) \times (1.01 \text{ to } 1.05) = \$208,121 \text{ to } \$243,101$
2008-09	$(\$208,121 \text{ to } \$243,101) \times (1.01 \text{ to } 1.05) = \$210,202 \text{ to } \$255,256$

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For the low income exemption amount of \$250,000:

2004-05	$\$250,000 \times (1.01 \text{ to } 1.05) = \$252,500 \text{ to } \$262,500$
2005-06	$(\$252,500 \text{ to } \$262,500) \times (1.01 \text{ to } 1.05) = \$255,025 \text{ to } \$275,625$
2006-07	$(\$255,025 \text{ to } \$275,625) \times (1.01 \text{ to } 1.05) = \$257,575 \text{ to } \$289,406$
2007-08	$(\$257,575 \text{ to } \$289,406) \times (1.01 \text{ to } 1.05) = \$260,151 \text{ to } \$303,876$
2008-09	$(\$260,151 \text{ to } \$303,876) \times (1.01 \text{ to } 1.05) = \$262,753 \text{ to } \$319,070$

The inflation factor adjustment would affect only the claimants with AVs greater than \$200,000 for the basic exemption and \$250,000 for the low income exemption. The estimated effect of the inflation factor adjustment can be computed by multiplying the number of exemptions that would be affected by the maximum exemption amount times the inflation factor adjustment.

The effect for the estimated 2,071 basic claimants with an assessed value greater than \$200,000 is then:

2004-05	$2,071 \times \$2,000 \text{ to } \$10,000$	$= \$4,142,000 \text{ to } \$20,710,000$
2005-06	$2,071 \times \$4,020 \text{ to } \$20,500$	$= \$8,325,420 \text{ to } \$42,455,500$
2006-07	$2,071 \times \$6,060 \text{ to } \$31,525$	$= \$12,550,260 \text{ to } \$65,288,275$
2007-08	$2,071 \times \$8,121 \text{ to } \$43,101$	$= \$16,818,591 \text{ to } \$89,262,171$
2008-09	$2,071 \times \$10,202 \text{ to } \$55,256$	$= \$21,128,342 \text{ to } \$114,435,176$

The estimated effect for the 150 low income claimants with an assessed value greater than \$250,000 is:

2004-05	$150 \times \$2,500 \text{ to } \$12,500$	$= \$375,000 \text{ to } \$1,875,000$
2005-06	$150 \times \$5,025 \text{ to } \$25,625$	$= \$753,750 \text{ to } \$3,843,750$
2006-07	$150 \times \$7,575 \text{ to } \$39,406$	$= \$1,136,250 \text{ to } \$5,910,900$
2007-08	$150 \times \$10,151 \text{ to } \$53,876$	$= \$1,522,650 \text{ to } \$8,081,400$
2008-09	$150 \times \$12,753 \text{ to } \$69,070$	$= \$1,912,950 \text{ to } \$10,360,500$

### Revenue Summary

#### Increasing Exemption Amounts:

The annual decrease in property tax revenues at the basic one percent property tax rate under this bill is estimated to be:

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## Claimants currently receiving

Basic \$100,000 exemption	\$402.5 million x 1%	= \$4.0 million
Low income \$150,000 exemption	\$41.9 million x 1%	= <u>\$0.4 million</u>
Total		= \$4.4 million

**Inflation Factor Adjustment**

The decrease in property tax revenues for the five years due to the inflation factor adjustment is:

2004-05	[\$4,142,000 to \$20,710,000] + [\$375,000 to \$1,875,000]	x 1%	\$45,200 to \$225,900
2005-06	[\$8,325,420 to \$42,455,500] + [\$753,750 to \$3,843,750]	x 1%	\$90,800 to \$463,000
2006-07	[\$12,550,260 to \$65,288,275] + [\$1,136,250 to \$5,910,900]	x 1%	\$136,900 to \$712,000
2007-08	[\$16,818,591 to \$89,262,171] + [\$1,522,650 to \$8,081,400]	x 1%	\$183,412 to \$973,400
2008-09	[\$21,128,342 to \$114,435,176] + [\$1,912,950 to \$10,360,500]	x 1%	\$230,413 to \$1,248,000

**Qualifying Remarks**

Increases in the exemption amounts resulting from the annual inflation factor adjustment are expected to grow significantly over time because of the compounding effect of the adjustment. By the same token, the assessed values will be unable to maintain pace causing the number of the current low income claimants that will fall into the basic category to grow. Over time, only a few disabled veterans will need to file for the low income disabled veterans' exemption.

It is not possible to compute the number of new claims for the disabled veterans' exemptions in the coming years due to the uncertainty of the increase in the number of disabled veterans.

Local agencies are not currently reimbursed for property tax revenues lost to them as a result of the disabled veterans' exemptions.

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